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UNITED STATES DEPARTMENT OF AGRICULTURE
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The Processing Tax

WHAT is it? At the first point of processing basic farm products, for which there are adjustment programs, a tax is collected. Funds obtained from this processing tax are deposited in the Treasury of the United States. Funds approximately equaling these amounts are used primarily for benefit payments to adjust farm prices and production so that the farmer will receive a fair price or "parity" for the part of his production consumed domestically. Agricultural producers thus sell in a protected market.

WHO pays it? The processing taxes are ordinarily paid by the consumer. A fraction of a cent is added to the price of each loaf of bread or a few cents to the cost of a cotton shirt or a pound of pork chops. The processing tax is therefore one of the retail-price factors. Farm buying power is thus increased. The increased expenditures of farmers, made possible by their larger income, aid employment, stimulate industry, and augment factory pay rolls.

WHO gets it? Proceeds of processing taxes are passed to cooperating farmers as benefit payments. By means of the benefit payments, and the increase in farm prices due to adjustment of supply, the adjustment programs seek to restore and maintain the purchasing power of farm products in terms of things farmers buy, approximately at the pre-war level. This tends to keep domestic trade in balance. Both agriculture and industry, and the people living in cities or on farms, thus get a better deal. The purpose is to stimulate farm and city buying power, sustain wages, and improve trade.

A FARM Tariff Under American tariff policy, much of industry has enjoyed the privileges of a protected market for many years.

Under the A. A. A. program of adjustment, agriculture, too, has been given the benefit of a protected market.

I. Are Processing Taxes Necessary to Adjust Agriculture ?

People often ask why there is need to reduce or shift or adjust production.

Look at agricultural America as one big farm. Before the adjustment programs in 1933 about 370 million acres were planted. Crops were actually harvested from about 360 million acres. During 5 years of the "prosperity era", 1925–29, the American people ate

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the products from about 287 million acres of land each year. Factories in America used up the nonfood products such as cotton, tobacco, and flax from about 25 million acres more. The American people, in other words, consumed the products from 312 million acres of land.

Farmers exported the products from 66 million acres during the 5 years ending in 1929, but in 1932–33 this dropped to 44 million acres, and in 1933–34 less than 40 million acres produced crops for the export market.

The situation is this: Not more than 340 million acres of land are needed at present to produce for both the American and the foreign market, and the products from at least 20 million acres are without a ready market. As matters now stand, that excess can ruin prices for the entire production of the American farmer, as it did in 1932.

In the long run there may be other and better ways to keep the farmer's buying power up, but at present it seems that unless farmers adjust their production to what the market will buy at a fair price, farm income will fall to very low levels again.

Production will respond to market demands without processing taxes and without the present adjustment program if farmers are willing to pay the price. That process had started in 1932. Such a method would prevail as farmers responded to low prices by withdrawing lands from production, or as farmers were forced out of production.

Why Benefit Payments Are Justified in an Adjustment Program

The farmers' adjustment programs are designed to assure that the farmer gets a fair deal by helping him keep farm prices in line with other prices. That is what parity amounts to.

Not all farmers can make a success even if prices of farm products are kept in line with prices of things farmers buy. But where farm prices are seriously out of adjustment with other prices the farmer's depleted income will not permit him to care for his farm and family, pay his debts, carrying charges and operating expenses, and yet have some money left over with which he can buy the products of industry. Such a situation checks domestic trade, clogs markets, slows the demand for factory products and cuts pay rolls. It affects nearly everyone, whether in a city or on a farm. So parity is not charity. Parity attempts to give simple justice to the farmer, and also to the consumer, because it aims to prevent farm prices from being lifted too high.

Benefit payments are justified also because the tariffs on manufactured goods have been an important factor in reducing the farmer's export markets and have raised prices on what farmers have to

buy. The benefit payments help to put the farmer on an equal footing with tariff-protected industries. The processing tax is really the farmer's tariff. It, or something like it, will be needed as long as the Nation holds to high tariffs on manufactured goods.

From the point of view of agriculture, processing taxes and benefit payments are justified because they enable farmers to do for themselves what closely knit industrial organizations long have done—control production to secure fair returns. The benefit payment rewards the cooperating farmer and protects the cooperating majority against injury from the few who do not cooperate. Farmers' efforts to cooperate in the past often have been defeated by those farmers who sought to profit, through expanding production, from the effects of those who sought to curtail.

Various Methods of Adjustment

Adjustment of farm production to obtain fair prices might be obtained in a number of ways:

1. ***Voluntary adjustment, with benefit payments*** to protect cooperators against noncooperators. This is the general plan now being followed.

2. ***Voluntary adjustment, with penalties*** against those who refuse to cooperate. This method was followed in the 1934 rice program, and in part in the 1934 tobacco program. The Kerr-Smith Act taxed noncooperating tobacco farmers to take from them the increase in tobacco price caused by the program. The Kerr-Smith tax supplements and supports tobacco adjustment programs providing rental or benefit payments to cooperators.

3. ***Compulsory control of production.***

4. ***Buying up of submarginal land*** by the Government. It would take a long time to bring about much adjustment in commercial farm production through this means, because production from submarginal lands is only a minor factor in total supply.

Other Possible Sources of Money for Benefit Payments

There can be no benefit payments without either processing taxes or some other form of tax. Sources of income might be (1) increased income and inheritance taxes, (2) a general sales or luxury tax, (3) a tax on profits of processors and distributors, or (4) use of funds from the General Treasury, regardless of their source.

Processing taxes are levied on basic agricultural commodities for which adjustment programs are in effect. Tax money, obtained from the consumer of the particular product, is used to adjust the price situation. The lower the market price is below parity, the more serious is the surplus problem for that particular commodity, and

the higher the processing tax which can be levied. Farm leaders who have devoted study to the problem contend that there can be no assurance of continuity for any program which fails to provide a continuing source of revenue.

Thus if income taxes were increased, it might be urged that the additional revenue, instead of being used to make agricultural adjustment possible, should be used for such general social purposes as social insurance, scientific research, unemployment insurance, and the educational activities of the Federal Government.

A general sales tax that would provide the $500,000,000 a year which is approximately the sum now derived from processing taxes, would have to be at the rate of about 1¼ percent on the wholesale value of all manufactured commodities. A serious disadvantage in raising large funds through a general sales tax would be the pressure that would surely be brought to bear by representatives of different commodities to avoid the sales tax. The danger inherent in a program relying upon annual appropriations, which would be subject to discontinuance in any year, was foreseen by sponsors of the McNary-Haugen bill. They proposed the equalization fee, to be paid by farmers, as the continuing source of revenue for the McNary-Haugen plan. For the adjustment program, the problem was met by the provision for processing taxes.

II. The Processing Tax and How It Operates

Benefit payments to farmers cooperating in A. A. A. programs ordinarily do not come from annual appropriations of Congress. The payments are not adding to the public debt. They are balanced by processing taxes collected by the United States Bureau of Internal Revenue from the first domestic processors of farm products, that is, from millers, cotton textile manufacturers, packers, and other first processors.

Processing taxes are not assessed against farm products that are exported, and therefore do not, in themselves, have any effect on export trade.

What Decides the Rate?

The maximum rate of the processing tax is ordinarily the difference between the average farm price and the fair exchange value of the commodity, or " parity. "

Parity is not a set price. It is that price for the commodity which will make it exchange for the same amount of goods farmers buy as it would exchange for before the war, 1909–14. For instance, in 1932 it took nearly 2 bushels of wheat to buy as much industrial goods as one bushel would buy before the war. By adding 30 cents

per bushel to the 1932 market price of wheat the old buying power of wheat could be restored. That is why the processing tax on wheat was set at 30 cents per bushel, and most of this money was paid to cooperating farmers in the form of benefit payments.

The rate of the tax is fixed by the Secretary of Agriculture in accordance with rules laid down by Congress in the Agricultural Adjustment Act and amendments thereto.

If the full rate of the tax is found likely to cause consumption to be cut down and surpluses to pile up and injure market price the Secretary of Agriculture may lower the rate. This has been done in the case of corn.

Processing taxes tend to raise the wholesale or retail prices of the products on which they are levied. This may put these products at a disadvantage in competing with substitutes, and thus hurt the farmer. To keep competition in balance, compensating taxes may be levied on these substitute products. This has been done on jute and paper in the forms in which they come into competition with cotton.

In the same way compensating taxes, in addition to the tariff, may be levied on imported articles (like cotton goods) to keep the usual balance of competition between imported goods and those made in the United States.

Some States Pay More Processing Taxes Than Others

Naturally, collections of processing taxes are greater in some regions than in others. For instance, about one-fifth of all the processing taxes on wheat are collected in Minnesota. This does not mean that the people of Minnesota are being taxed more heavily than those who live in other States. The tax is distributed all over the United States in the form of slightly higher prices for wheat products milled in Minnesota.

In the same way nearly half the corn-hog processing taxes are collected in Illinois because Chicago is a great meat-packing center. Because North Carolina is a tobacco and cotton textile manufacturing region more than 19 millions out of 128 millions of dollars paid in cotton processing taxes were collected there, and nearly 4 million dollars out of 14 millions collected in tobacco processing taxes were gathered in that State.

Farmers do not have to pay processing taxes on products raised by themselves and used at home.

III. How Processing Taxes Have Helped Farmers

Not all the increases in farm prices since 1932 have been due to the processing-tax adjustment programs. The cheapened dollar and

the drought were partly responsible. Much of the large increase in total farm income, however, is due to the adjustment programs and benefit payments. The total American farm income in 1932 was about 4½ billion dollars; in 1933 it was a little over 5 billions; in 1934, in spite of the drought, it was about 6 billions.

The cotton income of 1932 was $483,912,000. In 1934 it was $871,-420,000. Of this increase, benefit payments contributed $115,400,000.

The wheat income in 1932 was 195 million dollars. In 1934 it was 382 million dollars. Of this $101,600,000 was in benefit payments.

In 1932 farmers sold about 12½ billion pounds of pork for 439 million dollars. In 1934 farmers sold about 11½ billion pounds of pork for 497 million dollars. They received in addition 159 million dollars in benefit payments.

In the case of tobacco, prices to consumers have in general not been increased, although prices to producers have risen, and the increased return to the producers has apparently come from a slightly narrower margin to the processor and distributor.

Sugar prices to consumers have not risen, while returns to growers have been increased by benefit payments, because a reduction in the sugar tariff, equal to the amount of the processing tax, has accompanied the imposition of that tax.

A relatively small percentage rise in the consumer's price usually is accompanied by a much greater percentage rise in the farmer's price. This is because the farmer's share in the retail price is usually very low and because costs of distribution usually remain about the same no matter what the price is. For example, in March 1933 the consumer paid an average of 3 cents a pound for flour of which the farmer got only eight-tenths of a cent. In March 1934 the consumer paid an average of $4\frac{8}{10}$ cents a pound, of which the farmer got $2\frac{3}{10}$ cents. While the consumer paid 60 percent more, the farmer's share was nearly tripled.

The only losses to middlemen from adjustment programs seem to be in temporary reduction of total business handled. In many cases middlemen have widened their margins to take care of the processing tax and other increased costs.

How the Tax Worked With Cotton

The 1933–34 processing tax on cotton came to about 115 million dollars. The value of that year's cotton crop, because of the adjustment program and other factors, increased by about 387 million dollars.

The annual consumption of cotton in the United States is, on the whole, relatively stable, and such variations as do take place are due more to general business conditions than to the price of the cot-

ton. It is estimated that American consumption of cotton is not affected by more than 300,000 to 400,000 bales as a result of the processing tax. The tax does not, of course, apply to cotton exported, and therefore does not increase the price of American cotton in foreign markets. Adjustment of the American crop helps to strengthen world cotton prices.

The 12-cent cotton loan may have had some influence on foreign and domestic markets, but this has nothing to do with the processing tax and adjustment program proper.

The cotton processing tax is $4\frac{2}{10}$ cents per pound. A rough rule for figuring how much that adds to the price of cotton goods is to multiply the number of pounds in a piece of cotton goods by $5\frac{1}{2}$ cents. It is estimated that the cotton processing tax has cost the American people an average of 93 cents per person per year, or less than 8 cents per month.

The higher income of cotton farmers has boosted American business activity, and has helped wage earners.

How the Tax Worked With Wheat

The consumption of wheat in America is fairly steady regardless of price. Consumption per person was $5\frac{4}{10}$ bushels in 1919–20; $4\frac{3}{10}$ bushels in 1924–25; $4\frac{4}{10}$ bushels in 1929–30; 5 bushels in 1932–33, and probably about the same for 1933–34.

The processing tax on wheat has not been borne by the millers but has been passed on to the consumer. The tax has not put wheat prices out of line with prices of other products and has decreased consumption little if at all. Since it does not apply to exported products, it has not hurt American wheat exports.

How the Tax Worked With Hogs

The amounts of wheat and cotton used in America are relatively stable, regardless of price. That is why consumers tend to pay a larger sum total for wheat and cotton products in years when the prices of wheat and cotton are higher. That is not the case with pork.

Consumers as a group spend about the same gross amount for pork, when their yearly incomes remain unchanged, regardless of price. If prices are low they eat more, if prices are high they eat less. This means that the chief gains to the hog farmer from an adjustment program are (1) saving himself the cost of producing more than people will eat at a fair price, and (2) saving himself the extra marketing cost of an excessive crop.

It has been asserted that farmers pay the hog processing tax. It has also been argued that consumers pay the tax, and the packers

have claimed that they pay it. All three stories have been told at the same time.

Certainly not all of the tax is paid by each of the three groups, at the same time.

When supplies of hogs are large there is what is known as a "buyer's market," and the processing tax appears to be paid largely by the farmer-seller. This condition held from November 1933, when the tax started, until late January 1934. During this period farmers shipped many hogs which the consumers would not have bought if the price had been high. The tax in that period appeared to be thrown back upon the farmer. The Government pig-buying program of the summer of 1933, in which about 6 million pigs and light hogs were taken off the market, had not been felt by that time because those hogs would not have reached the market yet.

Beginning in January 1934 the elimination of the hogs in the summer buying program began to be felt. The market gradually changed from a "buyers' market" to a "sellers' market." Hog prices to farmers rose from $3.06 January 15 to $3.86 March 15. During this period the processing tax appeared to be paid by consumers.

By the end of March 1934 shipments of hogs increased because of better prices, and again there was a "buyers' market." Hog prices to farmers declined. Then came the drought and more forced selling, and the condition continued. In the summer and fall of 1934 this condition changed again and since then there has been a "sellers' market" most of the time, with the tax apparently paid by consumers.

The tax began at 50 cents and was gradually increased until it was $2.25 per hundred pounds.

Whether farmers or consumers are paying the processing tax on hogs depends upon the sense in which the word is used. Farmers rather than consumers may be said to pay the tax in that its imposition, in the absence of any adjustment of supply, does not cause consumers to pay more per pound for pork. Since this is true, the tax may be said to reduce the price per pound of hogs received by farmers. But in another sense consumers rather than farmers pay the hog processing tax. It is by means of the tax that the adjustment of supply is brought about, and the price per pound is increased.

If the hog processing tax were for any reason suddenly removed, and supply and demand conditions for hogs remained unchanged, the market price of hogs might, temporarily at least, go up by at least a portion of the amount of the tax. But farmers no longer would receive benefit payments and as soon as uncontrolled production permitted the supply of hogs to be increased, the price would go down.

The fact is that regardless of who paid the processing tax, farmers received much more for hogs in 1934 than in 1933, not counting benefit payments. Even had they paid it all, the benefit payments would have refunded them the tax and the increase in total hog income would have been net gain. Total hog income for 1932 was 439 million dollars; for 1934 it was 656 million dollars, including benefit payments.

Did Cattlemen Benefit?

It has been said that beef cattle producers enjoyed price increases without processing taxes (prior to cattle-buying program). Comparing 1934 with the average of the 4 previous years, packers paid cattlemen in 1934, 9 percent *less* money for 19 percent *more* cattle (not including Government purchases); and paid hog producers 5 percent *more* money (including processing tax) for 8 percent *fewer* hogs.

IV. The Effect of Processing Taxes on Consumers

In 1934 total retail sales in the United States are estimated to have been about 28½ billion dollars. Processing taxes for 1934 were less than one-half billion dollars, or less than 2 percent of the total retail expenditures in that year. About half of the processing taxes collected did not represent added expenditures by consumers. Consumers spent no more for pork with the processing tax than they would have spent without it, although they got less pork for the money they spent; the sugar processing tax of 45 million dollars was offset by tariff reductions on sugar; and the 25 million dollars in tobacco processing taxes did not result in increasing retail prices.

What Is the Tax in Terms of Retail Prices?

A 30-cent-per-bushel wheat processing tax means about three-fourths of a cent more for a pound of flour which sells in city stores for about 5 cents per pound, or one-half cent more for a 1-pound loaf of bread which sells for an average of 8$\frac{9}{10}$ cents. The wheat farmers' income was increased more than 50 percent the first year.

The cotton processing tax of 4$\frac{2}{10}$ cents per pound on raw cotton adds about 8 cents to the price of a pair of overalls costing $1.60; less than 8 cents on a sheet costing $1.30; adds about 3½ cents to the price of work shirts which sell for about 90 cents; and adds about 1$\frac{1}{10}$ cents per yard to the cost of unbleached muslin which sells for 14 cents per yard. Yet despite this small cost factor, the processing-tax adjustment program played a big part in doubling the South's cotton income. The proceeds of the tax paid out in benefit payments increased income more than one-fourth.

The hog tax of $2.25 amounts to about 4½ cents per pound added to prices of retail pork cuts.

A very small increase in retail prices often means a very large increase in farm income.

Provisions in the Agricultural Adjustment Act protect the consumer against unlimited retail-price increases. The use of processing taxes, production adjustment, and benefit payments is limited to restoring purchasing power of farm products approximately to what they were before the World War. These provisions protect the consumer against having to pay more than is just to the farmer.

How the Program Has Helped Consumers

Increased farm buying power, brought about through increases in farm income, has helped the consumer. Unduly low food prices had been costly to consumers because these low prices had reduced the buying power of one-fourth of the Nation. This lost buying power of farmers, it is estimated, had put 4 million men out of work in the cities.

The revival of farm buying power was felt first in retail lines in agricultural States, and then in the populous industrial States. The benefit payments had a marked effect in causing money to be spent freely and quickly, with resulting good effects on business. These payments could not legally be attached for debt, and resulted in a large increase in buying power, by areas, in a very short time.

From March 1933 to June 1934, during the drought period, food prices rose 20 percent because of the effect of the cheapened dollar on the price of cereals, because of increased processing costs, because of the drought effect on grains, and to some extent because of the adjustment programs.

In 1934 the pay rolls in manufacturing industries went up faster than food prices did, and because incomes went up faster than food prices, consumers benefited. On the other hand, farm income went up faster and farther than prices of things the farmer buys. In March of 1933 the purchasing power of the farmer's products was about 55 percent of its pre-war purchasing power. In May of 1935 it was up to about 85 percent.

V. Arguments Concerning Processing Taxes

Arguments Against Processing Taxes

1. By making possible control of production of farm products, the processing tax tends to limit the volume of these products handled by some processors. The argument is made that this cuts down the need for labor in the processing plants and adds to unemployment. But proponents of the tax declare that from the standpoint of the

processors and their employees, stabilized production is preferable in the long run to alternate periods of surplus and shortage.

2. The processing taxes add to the bookkeeping of processors, and collection of the taxes entails additional administrative machinery in the Bureau of Internal Revenue.

3. The processing tax is the means of financing a program which, according to the view of some persons. is not a justifiable function of the Federal Government.

4. Another argument often heard is that the processing tax simply takes money out of the pockets of one group and puts it in the pockets of another.

5. Since collections of taxes in some States happen to be more than the amount of benefit payment in those States, critics sometimes represent that the effect of the tax is to discriminate between States.

6. Processing taxes may tend to lower the farm prices of some products below what they might be if the program were financed some other way. This might apply in the case of hogs. But even when this might be true, the benefit payments, general increase in farm income, and lessened cost of production tend to more than offset any such possible reduction in price.

7. Some say it is wrong to tax raw materials instead of the finished products, because the tax is apt to be pyramided; that is, every handler adding a little extra to the tax so that by the time it reaches the consumer the tax has been greatly increased. There is little evidence that this has taken place, and the act authorizes the use of publicity measures to prevent pyramiding and profiteering.

8. "The most serious objection to the processing tax, and one which merits careful consideration, is that the greatest burden falls on the poorer people. This is an important and legitimate criticism of the processing taxes." (Report of the Secretary of Agriculture, 1934, p. 36.)

But, as the Secretary has pointed out, given a certain price level for food, the effect on the poorer classes is the same whether the price results partly from the operation of a processing tax or entirely from the operation of supply and demand. "Parity" prices have been assumed by Congress to be fair prices both to consumers and farmers. If some consumers are too poor to pay fair prices for their food, the Agricultural Adjustment Act recognizes that the farmers scarcely can be expected to take exclusively upon themselves the burden of a problem which actually belongs to society in general. Instead the act assumes that the responsibility of looking after these poorer classes belongs to the whole people, and not to the farmers alone.

In the long run, however, farmers believe that many of the poorer people will be helped—have already been helped—by the processing-

tax adjustment program, which has revived farm buying power for city factory products, thus putting more people to work. Farm income and factory pay rolls rise and fall together.

Arguments for Processing Taxes

1. The processing tax provides a continuing and reliable source of revenue, lessening dangers of interrupting programs because of failure of Congress to make annual appropriations.
2. The processing-tax benefit-payment adjustment programs are planned to operate without adding to the public debt or direct appropriations from the Treasury.
3. The processing tax is easy and inexpensive to collect, and hard to evade.
4. The annual proceeds from processing taxes can be forecast with reasonable certainty.
5. Processing taxes apply only to the domestically-consumed part of farm production, and do not penalize the exporter.
6. The farmer is not taxed on products raised for his own food.
7. Processing tax rates can be quickly and easily adjusted to meet changing economic conditions.
8. Processing-tax and benefit-payment adjustment programs offer the best means thus far devised, for organizing farmers into an effective cooperative effort to adjust their industry for the benefit of themselves and of society as a whole.

SUGGESTED REFERENCES

The following publications may be secured, without charge, from the sources below as long as supplies are available:

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